UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Southern California Edison Company and San Diego Gas & Electric Company	Docket No. EC89-5-000

U.S. DEPARTMENT OF JUSTICE BRIEF OPPOSING EXCEPTIONS TO THE INITIAL DECISION OF THE ADMINISTRATIVE LAW JUDGE

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The U.S. Department of Justice ("Department" or "DOJ") submits the following Brief Opposing Exceptions to the Initial Decision of the Administrative Law Judge, filed by various parties to this proceeding on December 27, 1990.1/

I. INTRODUCTION

The proposed merger between Southern California Edison ("SCE" or "Edison") and San Diego Gas and Electric ("SDG&E") (collectively "Applicants") raises certain competition and economic efficiency concerns. Applicants' Additional Proposed Conditions ("Additional Conditions")

1/ This Brief is submitted pursuant to Rule 711 of the Rules of Practice and Procedure of the Federal Energy Regulatory Commission. 18 C.F.R. § 385.711.

adequately address and alleviate these concerns. It is therefore the Department's position that any approval of the merger of SCE and SDG&E be subject to the imposition of the Additional Conditions by the Federal Energy Regulatory Commission ("FERC" or "the Commission"). This reply brief addresses arguments submitted by the FERC Staff concerning the use of the auction mechanism set forth in the Additional Conditions to allocate the transmission entitlements.

II. THE COMMISSION SHOULD NOT REJECT THE AUCTION MECHANISM PROPOSED IN THE ADDITIONAL CONDITIONS

The FERC Staff argues that the Applicants' Additional Conditions should be rejected entirely if the auction proposal contained within those conditions is an inseparable part of the Additional Conditions. FERC Staff Brief on Exceptions (B.E.) at 201. The gist of the FERC Staff's argument is that FERC precedent permits an auction mechanism to set prices only after the Commission makes an appropriate finding that a seller of transmission lacks market power. On that basis, the Staff argues, the Commission can find that the rates under the Additional Conditions auction would be just and reasonable. FERC Staff B.E. at 200, citing Baltimore Gas and Electric Co., 40 FERC ¶ 61,170 (1987).

The Additional Conditions propose to address and alleviate competitive and economic efficiency concerns that have arisen as the result of this merger and are designed, at a minimum, to maintain the competitive status quo. The Applicants are not, as in Baltimore Gas, proposing a voluntary auction as an alternative to a normal tariffed transaction,2/ but rather are offering, as a condition of this merger, a compulsory divestiture of transmission entitlements that is sufficient to maintain at least the same degree of competition that would exist without the proposed merger. Thus, an important distinction between this forced divestiture and a voluntary auction is that the merged company will not retain the option of withholding transmission if it is dissatisfied with the bids, so long as these bids are 90 percent or more of the filed rate. The auction is not

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2/ In the Baltimore Gas case, the parties sought to convince FERC that prices set by auction are inherently competitive and therefore reasonable under regulatory standards. FERC rejected this argument--an auction conducted by a seller with market power may yield bid prices that reflect the seller's market power. However, the issue here is not whether an auction is a reasonable substitute for rate regulation in a case where the seller possesses market power, but whether an auction mechanism provides assurance of resource allocation that is more efficient than other methods of allocating the divested transmission, and second, whether the auction will lead to higher transmission prices than some other method of allocating the transmission to be divested.

proposed as an alternative to regulated rates. Bidders know they can continue to purchase non-divested transmission at the regulated rates and will limit their auction bids to reflect that option. Accordingly, it does not follow that the merged company will be able, through the auction, to exploit any pre-existing unexercised market power. The auction will insure, however, that those entities that place the highest value on the transmission and therefore will use it the most efficiently will receive that transmission.

The Commission has ample latitude to approve the auction under these circumstances. The Commission's power to impose conditions to alleviate the competitive concerns posed by mergers3/ and its great flexibility in adopting proposals for power and transmission allocation and pricing are well established.4/ The Additional

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3/ Utah Power & Light, 45 FERC ¶ 61,095 at 61,280-83 (1988).

4/ Recently, the Commission has adopted a variety of voluntary proposals, (after consideration of market power), that involve more flexible, market-based allocation and pricing schemes for power purchases and transmission: Enron Power Enterprise Corp, 52 FERC ¶ 61,193 (1990); Commonwealth Atlantic Limited Partnership, 51 FERC ¶ 61,368 (1990); Public Service Company of Indiana, Inc., 51 FERC ¶ 61,367 (1990); Doswell Limited Partnership, 50 FERC ¶ 61,251 (1990); Citizens Power and Light Corporation, 48 FERC ¶ 61,210 (1989); Pacific Gas and Electric (Modesto Irrigation District), 44 FERC ¶ 61,010, order on rehearing 45 FERC ¶ 61,061, order on compliance, 46 FERC ¶ 61,390 (1989); Pacific Gas and Electric Co. (Turlock Irrigation District), 42 FERC
(Footnote continued on next page.)

Conditions present the Commission with the opportunity to fashion a flexible, economically efficient, and competition-promoting mechanism to address and alleviate the competitive concerns raised by this merger.

The Additional Conditions provide that bids be at least 90 percent and at most 120 percent of a defined base rate. That base rate is the rate on file with the FERC by the merged company on the date of the merger.5/ The bid minimums and maximums establish a certain flexibility around the FERC filed rate that will allow the auction to allocate the transmission efficiently while still insuring that the rates charged are at levels close to those that have been set through established rate setting procedures. The Commission thus can be confident that, under these special circumstances, rates are within the zone of reasonableness.6/

(Footnote continued from previous page.)
¶ 61,406, order on rehearing, 43 FERC ¶ 61,403 (1988); Orange and Rockland Utilities, 42 FERC ¶ 61,012 (1988); Baltimore Gas and Electric, 40 FERC ¶ 61,170 (1987); Pacific Gas and Electric, 38 FERC ¶ 61,242 (1987)(Western States Power Pool experiment).

5/ Additional Conditions, ¶¶ I.A.6, I.B.5.

6/ The Commission's discretion to accept a just and reasonable rate within an established zone of reasonableness has been clearly established. See Federal Power Commission v. Conway Corporation, 426 U.S. 271, 278 (1976); Jersey Central Power and Light v. FERC, 810 F.2d 1168, 1177 (D.C. Cir. 1987); Alabama Electric Cooperative v. FERC, 684 F.2d 20, 27 (D.C. Cir. 1982).

The auction allows bidders to pay a limited amount above the filed rate for the auctioned transmission. However, given the unique features of the auctioned transmission, it would not be surprising that entities participating in the auction choose to bid more than the cost of transmission service at the FERC filed rate. The transmission entitlements under the Additional Conditions may be perceived as more valuable than regulated transmission because they have attributes similar to ownership that give the entities purchasing such entitlements a substantial degree of flexibility and control over the use of the transmission entitlements which they purchase.7/ Furthermore, the Additional Conditions allow an entity that successfully bids for transmission to resell all or part of its entitlement to any other entity and allow for the creation of a facilitator so that entities with entitlements can

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7/ The Additional Conditions allow entities to bid for a variety of combinations of delivery points. Additional Conditions, ¶¶ I.A.3, I.B.2. Entities purchasing entitlements are allowed to make scheduling changes on short notice in the amount of and delivery points for the power transmitted. Additional Conditions, ¶ I.A.3.

aggregate unused transmission and participate in a secondary resale market.8/

Under the Additional Conditions, the merged company will be auctioning off an amount of transmission that will alleviate the competitive concerns presented by this merger. If the same transmission were instead allocated by regulatory fiat, it is almost certain to be allocated less efficiently.9/ The auction allows market forces to determine the efficient allocation. The minimum and maximum bid provisions, structured as percentages of a FERC filed base rate, provide the flexibility for efficient allocation of the transmission within a general zone of reasonableness around a FERC-regulated rate.

8/ Additional Conditions, ¶ I.C.

9/ Even were there is a secondary resale market, needless and potentially significant transactions costs would be incurred to correct this inefficient allocation.

III. CONCLUSION

The auction mechanism poses an appropriate and efficient method of allocating the transmission to be divested pursuant to the Applicants' Additional Conditions, and the Department urges that any approval of the proposed merger by the Commission include with Applicants' Additional Conditions the auction provisions.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that I have caused to be served a copy of the U.S. Department of Justice Brief Opposing Exceptions to the Initial Decision of the Administrative Law Judge on each person listed on the Service List in Southern California Edison Company and San Diego Gas & Electric Company, Docket No. EC89-5-000.

Dated at Washington, D.C. this 16th Day of January, 1991

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